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Supreme Court of the United States

OCTOBER TERM, 1949.

No. 505.

TRANSPORT, TRADING AND TERMINAL CORPORATION,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

PETITIONER'S REPLY BRIEF.

ARTHUR A. BALLANTINE,
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Counsel for Petitioner.

January, 1950.

INDEX.

PAGE

1. The holding of the court below is directly in conflict with the principles affirmed in the *Cumberland* case 3

   (a) that determination of whether a sale has been made by a corporation or its stockholders is a question of fact for the trial court; and 3

   (b) that a distribution in kind by a corporation to its stockholders, found by the trial court to be genuine, cannot be disregarded because undertaken to save a tax on the distributing corporation 3

2. Everything which this Court has said in the *Cumberland* case in defining the tax consequences of a distribution in kind made in liquidation is equally applicable to dividends in kind 7

CONCLUSION 9

Citations.

Cases:

	PAGE
Commissioner v. *Court Holding Co.*, 324 U. S. 331 (1945)	3
General Utilities & Operating Co. v. *Helvering*, 296 U. S. 200 (1935)	9
Gregory v. *Helvering*, 293 U. S. 465 (1935)	4, 9
E. C. Laster, 43 B. T. A. 159, 176 (1940)	5
Tennessee-Arkansas Gravel Co. v. *Comm'r*, 112 F. 2d 508 (6th Cir. 1940)	5
United States v. *Cumberland Public Service Company* (No. 214, October Term, 1949)	1, 2, 3, 4, 6, 7, 8, 9

Statutes:

Internal Revenue Code:	
§22(f)	8
§45	5
§111(a)	8
§111(b)	8
§115(a)	5

Other Authorities:

Reg. 103.	
§19.45-1(c)	5

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It is now clear that the petition for a writ of certiorari should be granted as the decision below is in square conflict with the decision of this Court in *United States* v. *Cumberland Public Service Company* (No. 214, October Term, 1949), rendered January 9, 1950, after the petition herein was filed.

The whole argument turns on the holding of the court below that a dividend in kind of certain stock from the petitioner to its parent company, which the Tax Court found was not "unreal or a sham" but was "genuine • • • unconditional and final", should be disregarded, and a subsequent sale of the stock imputed to petitioner, on the ground that the dividend distribution was made in order to escape a tax.

This Court held in the *Cumberland* case that a distribution in kind by a corporation to its stockholders, which the trial court found to be genuine, could *not* be disregarded, and a sale of the distributed property, made by the stockholders, imputed to the corporation, on the ground that the distribution in kind was made in order to escape a tax.

The conflict between the decision of the court below and the decision of this Court in the *Cumberland* case is clear and in itself warrants the grant of a writ in this case. That case, like this, arose because a stockholder of a corporation sold property received from the corporation, and in each case the Commissioner asserted a corporate tax liability on the theory that the distribution to the stockholder should be disregarded because made in order to save a tax. This theory was rejected by this Court in the *Cumberland* case but accepted by the court below in this case.

Contrary to the Commissioner's suggestion, no valid distinction can be drawn between this case and the *Cumberland* case on the ground that this case involves a dividend in kind whereas the *Cumberland* case involved a distribution in kind made in liquidation. In each case, the question is simply: Who made the sale—the distributing corporation or its stockholders? On this question, as this Court said in the *Cumberland* case,

> "It is for the trial court, upon consideration of an entire transaction, to determine the factual category in which the particular transaction belongs."

In view of the substantial identity of the issues in this case and the *Cumberland* case, denial of the writ in this case would amount to a negation of everything that this Court so recently said in the *Cumberland* case.

1. The holding of the court below is directly in conflict with the principles affirmed by this Court in the *Cumberland* case:

(a) that determination of whether a sale has been made by a corporation or its stockholders is a question of fact for the trial court; and

(b) that a distribution in kind by a corporation to its stockholders, found by the trial court to be genuine, cannot be disregarded because undertaken to save a tax on the distributing corporation.

In the present case the Tax Court held that the sale here involved was not "in substance" a sale by petitioner within the rationale of *Commissioner* v. *Court Holding Co.*, 324 U. S. 331 (1945), because there were no negotiations for the sale of the stock in question prior to a genuine distribution thereof as a dividend in kind.*

These findings of the Tax Court, based upon adequate supporting findings, were conclusive upon the reviewing court, under the decisions of this Court in both the *Court Holding* and *Cumberland* cases.

The Commissioner attempts to support the decision below by arguing that the Tax Court erred, as a matter of law, in holding that the dividend distribution was genuine and that the sale was not made by petitioner because, so the Commissioner says, the distribution was a "device" to avoid taxation (Br. in Opp., p. 13). This same argument was advanced by the Commissioner in the *Cumberland* case. (See page 13 of Commissioner's brief in the *Cumberland*

* In contrast, in the *Cumberland* case there had not only been negotiations for the sale of the property prior to the distribution thereof to the stockholders but the stockholders had entered into a formal contract to convey the property which they proposed to acquire from the corporation through its dissolution.

case, citing *Gregory* v. *Helvering*, 293 U. S. 465, and other cases cited at page 13 of his brief in opposition here.) This Court answered such argument as follows:

> "Here, on the basis of adequate subsidiary findings, the Court of Claims has found that the sale in question was made by the stockholders rather than the corporation. The Government's argument that the shareholders acted as a mere 'conduit' for a sale by respondent corporation must fall before this finding. The subsidiary finding that a major motive of the shareholders was to reduce taxes does not bar this conclusion. Whatever the motive and however relevant it may be in determining whether the transaction was real or a sham, sales of physical properties by shareholders following a genuine liquidation distribution cannot be attributed to the corporation for tax purposes."

The same answer applies to the Commissioner's argument here and requires the reversal of the decision below. To say, as the court below did, that the dividend in kind should be disregarded because it was "only a step in the means by which it [the parent] intended to carry out the sale" is simply a different phrasing of the "conduit" argument rejected by this Court in the *Cumberland* case. To say, as the court below did, that the dividend in kind should be disregarded on the theory that it was not a "dividend" within the meaning of §115(a) I. R. C., because undertaken for tax-saving purposes, was simply a roundabout way of stating the same rejected argument.

The answer to all such arguments, no matter in what form stated, is, as this Court held in the *Cumberland* case, that they must fall before findings of the trial court that the sale in question was made by stockholders, rather than the corporation, following a genuine distribution.

Significantly, the Commissioner makes no attempt to defend the decision below on the ground that the distribution did not constitute a "dividend" within the meaning of §115(a) because undertaken for tax-saving purposes—the theory upon which the court below rested its decision. Instead, the Commissioner cites another section of the Code, never before relied upon in this case either in the Tax Court or in the court below, viz., §45 I. R. C., which authorizes the Commissioner, in certain cases, to "distribute, apportion, or allocate" income among controlled organizations in order to prevent evasion of taxes or clearly to reflect the income of such organizations.

Section 45 could have no application to the present case. If petitioner had realized gain through negotiating a sale of the property in question, there would be no occasion to invoke §45 for the purpose of allocating such gain to the petitioner. If, on the other hand, as the Tax Court has held, the sale was made by petitioner's parent company, after receipt of a genuine dividend in kind, there was no income to the parent which could be allocated to petitioner under §45, because the proceeds of sale did not exceed the parent's basis for such property.* And the dividend income which the parent company derived from the receipt of the property as a dividend in kind was certainly not allocable to the petitioner which had paid such dividend.

Section 45 was intended to be applied to sham or fictitious transactions (Reg. 103, §19.45-1(c)). It cannot be applied to a dividend in kind which the Tax Court has found to be genuine, unconditional and final, and not sham

* The courts have held that §45 may not be used to create income where none exists. *Tennessee-Arkansas Gravel Co.* v. *Comm'r*, 112 F. 2d 508 (6th Cir. 1940); *E. C. Laster*, 43 B. T. A. 159, 176 (1940).

or unreal. As the Tax Court said, corporations are organized "with the expectation that dividend payments will eventually result from their operations" (R. 12). This is the answer to the Commissioner's assertion that no bona fide reason can be suggested for the declaration of the dividend.

Neither in the court below nor in this Court has the Commissioner challenged the adequacy of the evidence supporting the Tax Court's findings. He seeks here to emphasize two extraneous facts found by the Tax Court and weighed by it in arriving at its determination that the dividend was genuine and that the petitioner did not negotiate the sale. These extraneous facts are, first, that three years prior to the dividend in kind the petitioner acquired the stock in question from its parent in a transaction which gave rise to a deductible loss to the parent. As the record shows, this loss was sustained upon a sale made at public auction and was allowed by the Commissioner after careful audit (Cert. Tr. 174-5). The second fact stressed by the Commissioner is that petitioner's parent made a substantial investment in petitioner in the same year in which the dividend in kind was declared. As the Tax Court's opinion shows, this investment was made to enable the petitioner to carry out current business transactions of importance (R. 7-8).

It is submitted that the Tax Court was correct in considering that neither of the circumstances mentioned could have any bearing in determining whether petitioner had negotiated a sale of the stock in question to Dant prior to the payment of the dividend in kind. Certainly neither of such circumstances affords any valid ground of distinction between this case and the *Cumberland* case which could warrant denial of the writ here.

2. Everything which this Court has said in the *Cumberland* case in defining the tax consequences of a distribution in kind made in liquidation is equally applicable to dividends in kind.

In the *Cumberland* case this Court stated the basis of its decision as follows (slip opinion, pp. 4-5):

> "While the distinction between sales by a corporation as compared with distribution in kind followed by shareholder sales may be particularly shadowy and artificial when the corporation is closely held, Congress has chosen to recognize such a distinction for tax purposes. The corporate tax is thus aimed primarily at the profits of a going concern. This is true despite the fact that gains realized from corporate sales are taxed, perhaps to prevent tax evasions, even where the cash proceeds are at once distributed in liquidation. *But Congress has imposed no tax on liquidating distributions in kind* or on dissolution, whatever may be the motive for such liquidation.
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>
> " * * * a corporation is taxed if it sells all its physical properties and distributes the cash proceeds as liquidating dividends, yet is not taxed if that property is distributed in kind and is then sold by the shareholders.* * *
>
> *"Congress having determined that different tax consequences shall flow from different methods by which the shareholders of a closely held corporation may dispose of corporate property, we accept its mandate."* [Italics added.]

The foregoing reasoning is equally applicable here. Congress has imposed no tax upon a corporation paying

a dividend in kind, whatever may be the motive for such dividend. Congress has provided in §§22(f) and 111(a) and (b) I. R. C. that gain from the disposition of property shall be measured by what is *received* from such disposition. A corporation distributing property pursuant to a dividend in kind receives nothing on account of such distribution; therefore, under the statute, such corporation owes no tax with respect thereto.

Congress having provided that no tax shall be payable in respect of the distribution of dividends in kind, the court below should not have undertaken to defeat the Congressional mandate by holding that a genuine dividend in kind should, as a matter of law, be disregarded, and a subsequent sale of the distributed property imputed to the distributing corporation, on the ground that the distribution was made to escape a tax.

The Commissioner suggests that the rule of the *Cumberland* case should be restricted to liquidations, and points out that in the passage of the opinion quoted above the Court said: "The corporate tax is thus aimed primarily at the profits of a going concern." In this connection the Commissioner states (p. 12) that the transfer of the stock here in question was made "while petitioner was actively engaged in business" so that a sale by petitioner would have resulted "in its having realized normal business profits." The fact is, of course, that the taxpayer was engaged in shipping, terminal, dock and warehouse operations, that the stock here in question was a capital asset and not an asset held for sale in the ordinary course of petitioner's business, and that any gain that petitioner might have realized had it sold the stock would have been capital gain and not, as the Commissioner says, "normal business profits."

Aside from these facts, when the above-quoted sentence from the Court's opinion is read in its context, it is clear that the Court did not mean thereby to imply that the corporate tax was "aimed" at dividends in kind paid by a continuing corporation; rather, the Court was simply directing attention to the fact that sales made by a corporation, whether as a going concern or while in process of liquidation, are subject to the corporate tax, whereas Congress has not imposed the corporate tax on distributions made in liquidation.

So also, Congress has not imposed the corporate tax on dividends in kind of appreciated property distributed by a going corporation. The holding of this Court in *General Utilities & Operating Co.* v. *Helvering,* 296 U. S. 200 (1935), is square authority for this proposition. The Commissioner says (p. 14) that "there has been considerable confusion as to the precise holding" of the *General Utilities* case on this point. There is no such confusion, however, in the mind of the Tax Court which, as shown in the petition herein (p. 23), has cited and followed the *General Utilities* case not only in this case but in every other case in which the question has been raised whether dividends in kind give rise to income. In no case has the Commissioner prosecuted an appeal from a decision of the Tax Court on this point.

Conclusion.

The decision below is wrong. It conflicts with the decision of this Court in the *Cumberland* case and misconstrues the decision of this Court in the *Gregory* case. Denial of the writ herein would be regarded by the lower courts as a clear indication that the principles laid down

by this Court in the *Cumberland* case are not general but applied only to the particular case before the Court, or, at most, apply only to distributions in kind made in liquidation. The petition for a writ of certiorari, accordingly, should be granted.

Respectfully submitted,

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January, 1950.